RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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Feb. 26, DJIA 824.39; PTI 1343; A-D Ratio –25.87
Mar. 5, DJIA 807.26; PTI 1334; A-D Ratio –26.37

THE PICTURE: I wrote this last year, but I don't think many people "took it in." I'll try again now. There's a good chance that we're facing a world slump and a world deflation. How do I know that? The markets are telling me. Over the past two years bonds crashed, commodities collapsed, oil prices tumbled, gold and precious metals caved in, diamonds and colored stones fell apart, and now the price of homes is sagging. The only item left, I said, "is the stock market."

Then last June my PTI (Primary Trend Index) topped out, and a month later (on July 2) the Dow Theory gave it's signal for a primary bear market in stocks. Since then (measured by the Wilshire 5000 index) the stock market has lost roughly $300 billion in values. What does it all mean? I think it means deflation, pure and simple—along with a severe recession that could turn out to be a world depression.

Consider this. For 40 years Americans have lived with the concept that "it's smart to borrow." It was considered smart to borrow, because when you borrow you are getting the goods now, but you (cleverly) pay later with inflated or "cheap dollars." By 1980 the entire nation, from government to corporations to individuals, was in debt up to its neck. During 1980 I wrote repeatedly that "when everyone is positioned in one direction, the market gets ready to pull the rug out from under them."

The signal for rug-pulling was the blow off in gold in 1980. At 850 gold had discounted the full inflation story. From then on, it was down for gold and the majority of world prices.

But the full story hasn't been told yet. When deflation comes in, the game rules are REVERSED. Now all that borrowing and debt will have to be paid off with increasingly scarce and expensive dollars. Deflation means that the price of "everything" is worth less in terms of dollars. Whereas goods are scarce during inflation, dollars become scarce during deflation.

But the big problem during deflation is that there is always a danger of a credit collapse. Deflation is the economic equivalent of a "show your hand" in poker. The bluff is over, and if you haven't got the cards (i.e., liquidity) you fold. Whether American (and perhaps world) business "folds" is what we'll find out in the months ahead.

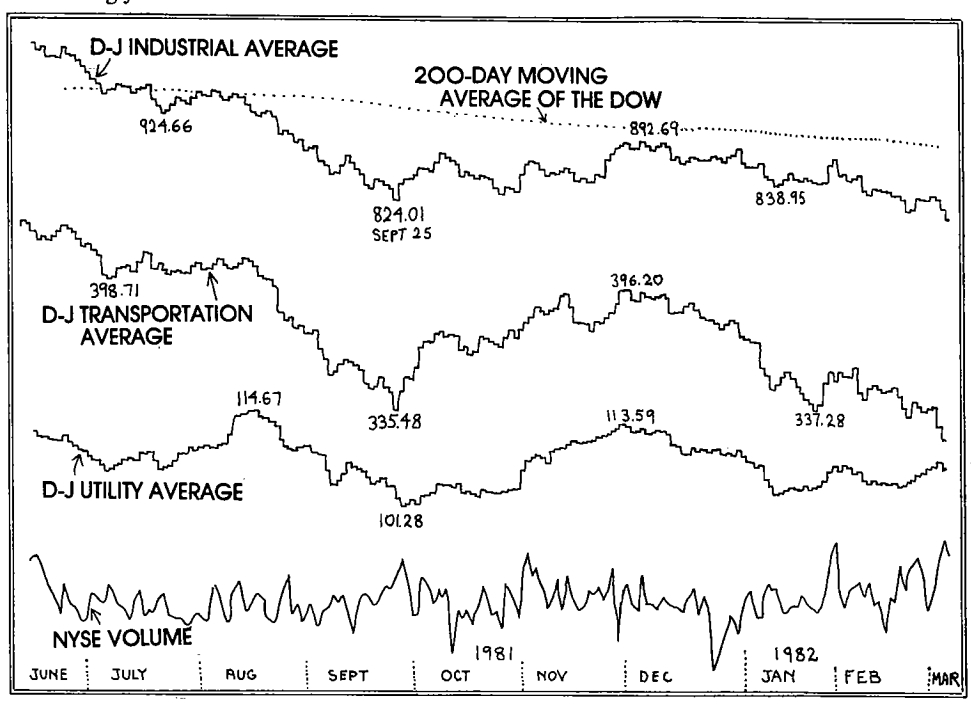
In the meantime, I've tried with whatever talent, knowledge and experience I possess to ready my subscribers for this situation. I've begged, cajoled, argued and reasoned for a safe and liquid position in US Treasury bills. Those of you who heeded my words are in a fine position to withstand the bear.

FRONT PAGE COMMENT: The Reagan budget as it stands, projects combined Federal deficits of $345 billion between now and 1985. Then along comes the Congressional Budget office predicting combined 1982-85 deficits of $501 billion!

What happens next? What will happen is what always happens—a compromise that fails to solve the problem. My guess is that some military and some civilian spending will be cut—but not much. Taxes may be raised either by a surcharge or a partial rescinding of the Reagan cuts. But in the face of a projected half trillion dollar deficit over four years, the compromises won't be that significant.

Then what happens? Interest rates will stay in a generally high area, business will (possibly) improve a bit during the warm months, but the recession-depression will drag on. OK, then what happens? Problems, political recriminations, slumping business profits, more unemployment—and ultimately a river of red ink. But one way or another the current $5 trillion in total US debt must face partial liquidation. The nation, to put it bluntly, is in for hard times.

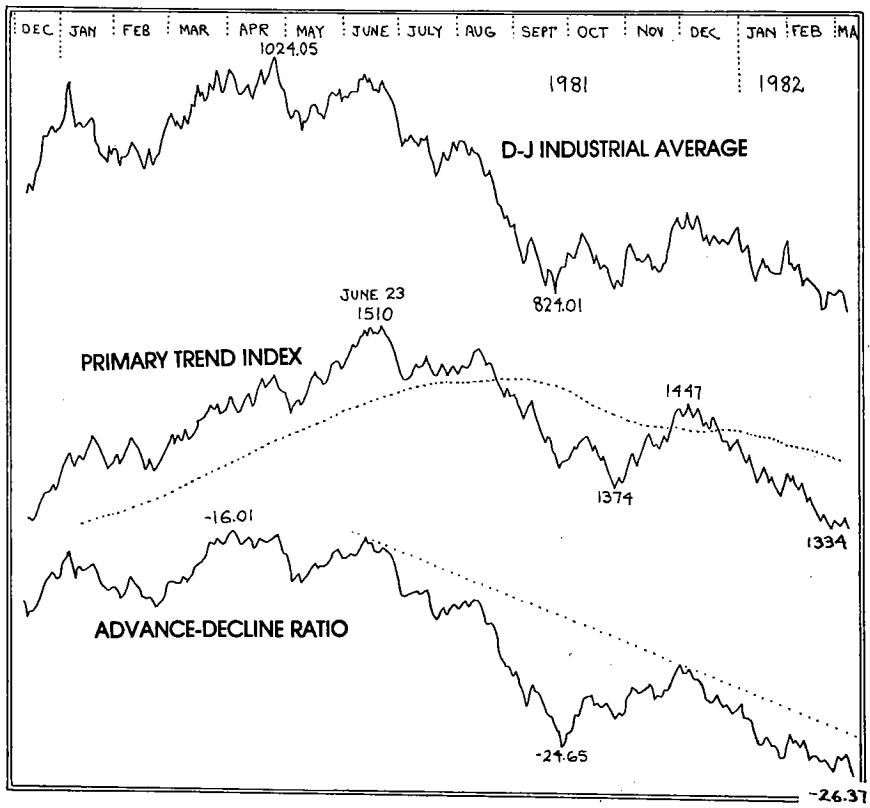
Almost daily we read where some Administration spokesman or some name economist predicts that "the economy will turn up in the spring" or "business will roar by mid-year." The fact is that neither you nor I nor any of these gentlemen has the foggiest notion about when business will turn up. In the meantime, the markets, in their cold and unsparing way, are telling us that the storm clouds are still overhead. The primary trend of the market is down, and that fact overrides all the advice and guesses that this nation's experts can muster.



THE MARKET: The most important single fact about this market is that it's a primary bear market, and the long-term trend is down. That fact should overrule every other consideration. To ignore it is tantamount to running up the "down escalator" in Macy's. You may beat the machine, but it won't be worth it.

Since the last mailing BOTH Averages (D-J Industrials and Transports) have broken decisively below their September lows (page 1 chart). In so doing, the Averages reconfirmed the primary bear trend. Last week saw liquidating volume of 70 and 74 million shares on two successive days as Industrials approached the 800 level. Would you believe that this level (800) was first tested (on the upside) in 1964!

Over the near-term subscribers (particularly those who are tempted to put out shorts or buy puts) should recognize these facts: (1) the broad Wilshire 5000 Index has been DOWN every week but one in 1982. (2) the A-D ratio on the NYSE has been DOWN for 11 of the past 13 weeks. This constitutes a lot of downside compression, and for this reason the market could turn and crush the shorts almost without warning.



The urge to out-trade, to out-wit, to beat this market, is running high. I think the volatility of the 1982 action has something to do with that urge. But I warn my subscribers–don't get greedy. Most of you are up to your necks in T-bills, and you're feeling good, you're even feeling cocky. Take it easy. Be humble. Exercise patience. This is the world's toughest game, and we need all the help we can get. Before this year is out probabilities favor the appearance of an outstanding "buy area" in this market. That's what I'm waiting for, but I haven't seen it–yet.

PRIMARY TREND INDEX: Through a quarter century in this business, I guess I've tried (at one time or another) almost every technical approach to the market ever offered. You name it; odd lots, short interest, short ratios, buying power and selling pressure, members' trading, trendlines, Dow Theory, contrary opinion, volume studies, OB volume, most-actives, on and on into the night. I've tried every one I could get my hand on.

What are my conclusions? (1) My first conclusion is that there is no infallible system. The great Dow Theorist, Robert Rhea, wrote that he spent a lifetime trying to track down "the rainbow's end", but ultimately he realized that there is no pot of gold on Wall Street–there are only probabilities. In the investment business we try to push the odds and probabilities as far as possible in our direction, but as to perfection or 90% or even 85% accuracy, forget it!

(2) Over the years I've concluded that the most valuable studies are those having to do with the ACTION of the market itself. In other words, what I find most informative, most valuable, are those studies which tell me WHAT THE MARKET IS ACTUALLY DOING. Such studies include the action of the averages and the action of individual stocks, volume, advance-decline studies, most-active stock studies, high-low studies, bond movements, trendline studies, etc.

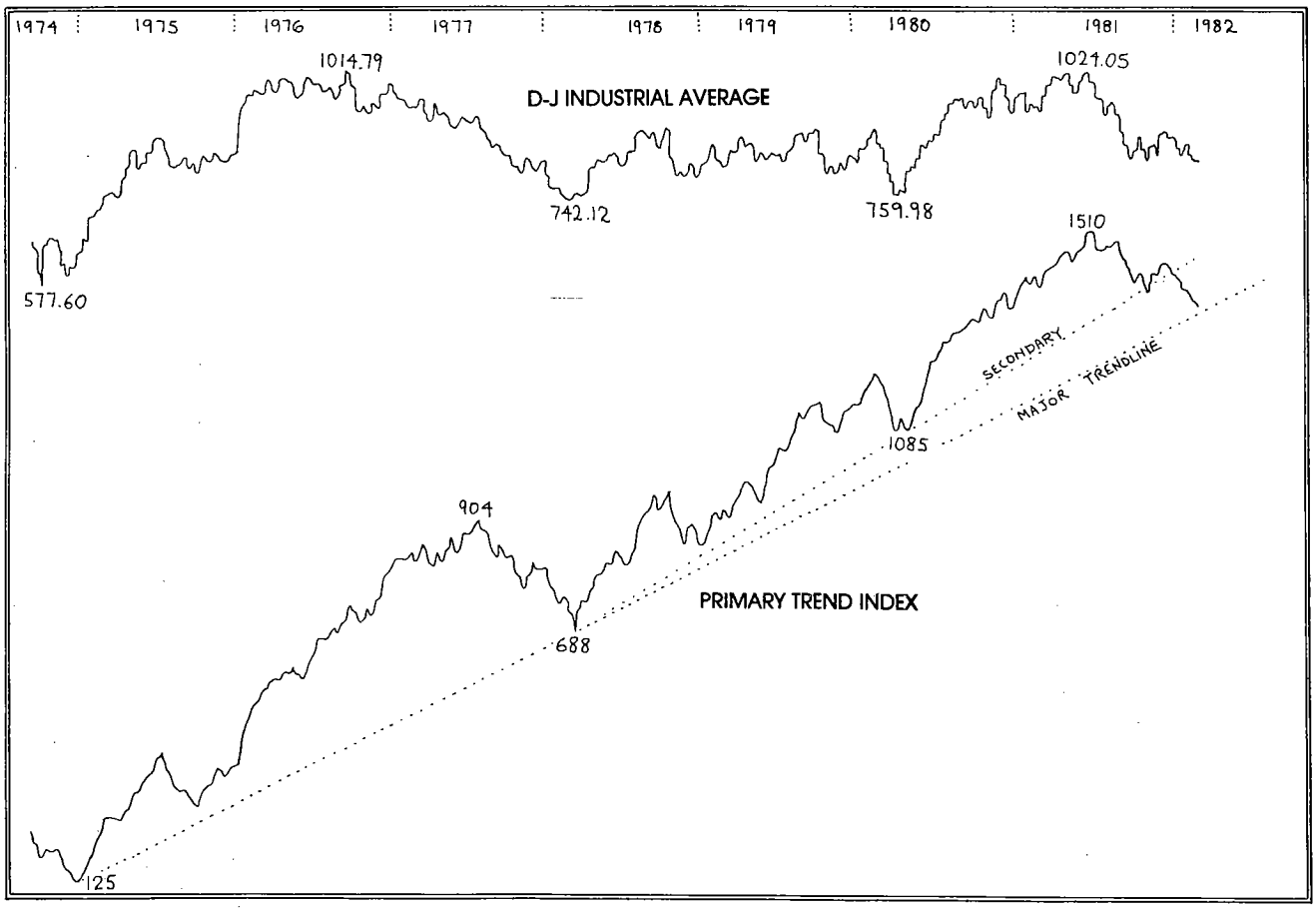
I prefer these to psychology (sentiment) of the market studies such as odd-lots, short interest, debit and credit studies, contrary opinion studies, percentage of advisory services that are bullish, etc. I have found the psychology of the market studies to be subjective, often inaccurate and of late–too widely followed.

I also operate on the principle that the market (in its actions) takes into account ALL OTHER studies, and when I say that I mean that the market discounts the sentiment studies as well. To put it another way, the action of the market is a reflection of everything everybody knows about the market including sentiment. Thus I prefer dealing with the actual movements, rather than attempting to "psychoanalyze" the market.

(3)Around the late 1960's I decided that I wanted my own indicator, a composite indicator, that was based on action of the market data. This, hopefully, would provide a method of tracking the market via a collection of different tools. The theory was that one or two market indicators or averages might be deceptive at times, but a battery of 5 or 10 indicators would be reasonably trustworthy.

It was thinking and experimenting along these lines that produced an amalgum of eight indicators all based on market action. I called this indicator the Primary Trend Index (PTI). Originally, I used the PTI as my own private check on the Dow Theory and the action of the Averages. But after 12 years of use I developed enough faith in the PTI to "take it public". Thus, subscribers now have the benefit of an instrument that I have been working with for about 12 years (on a daily basis). I thoroughly believe that the PTI is one of the most valuable tools that I have ever come across in this business.

I often marvel at the sheer amount of work that goes into man's attempt to beat the market. During any given month, literally millions of words are churned out regarding the trend of the



markets, the worth of various stocks, the direction of the economy, and so forth. The reader who attempts to keep up with even 5% of Wall Street's verbal output would shortly need a new pair of eyes.

As investors we have to deal with a strange paradox. The paradox is this–it would be marvelous if we could know everything there is to know about stocks and the economy. But in reality if we only knew ONE ITEM thoroughly we would be far ahead of the game. What is the ideal item? Simple, the one thing we must know is whether the trend of the market is up or down! And that is where the PTI is indispensible. The PTI tends to track the trend very well.

Take the recent and current situation. The PTI traced out a rising trend from its April, 1980 low of 1085 to its June, 1981 high of 1510. Then on August 21 the PTI broke its rising trend, and this was announced in Letter 816. At that point I drew a declining trendline which contained the new PTI action. The declining trendline was the signal to move OUT of the stock market and into treasury bills. This was done on the basis of my oft stated thesis that when the PTI moves down on a trend basis, sooner or later almost all stocks will follow to lower levels. Thus the investor who sits with a portfolio of stocks during a declining PTI situation is heading for losses–it's simply a matter of time. In fact, the longer the time span for a PTI decline, the greater the accumulated losses in a given stock portfolio. It has been eight months since the initial PTI bear signal, and the losses (as you know if you are holding stocks) have been mounting.

Turning to the daily chart (page 2) of the PTI, note that the indicator recorded a bear market low of 1341 on February 24. That low came while the PTI was 52 points below its (declining) 21-day moving average. Ordinarily, when the PTI drops 50 to 55 points under its 21-day moving average the indicator is considered over-sold. A rally back to the MA can then be expected. In very weak markets, however, the PTI will move sideways while waiting for the MA to come down. After a few weeks of consolidation (during which time the MA continues to decline) the PTI will begin a fresh leg down. We could be in that type of situation now.

Suffice it to say that the PTI is holding to its well-defined downtrend. As long as this declining trend is in force, the market will be in the grip of the bear.

The advance-decline ratio is a proxy for ALL the stocks on the NYSE. The A-D topped out on September 19, 1980. It moved generally sideways until April of 1981. In June (when the PTI topped out) the A-D started declining in earnest. I have drawn a descending trendline (see chart) through the June and November peaks. Since June the A-D has been falling at a rapid rate–while holding persistently BELOW its descending trendline. The A-D, like the PTI, is most definitely in the grip of the bear.

PTI: LONGER TERM: I discuss the near-term action of the PTI in each mailing, but the longer-term analysis must consider all the PTI action from the 1974 to the present. For this purpose, I have included this 8 year chart of the PTI.

The extreme low for the PTI came on the week of December 23, 1974–at a value of 125. From that historic low, the PTI entered a powerful and persistent bull market. The bull market carried all through the middle to late 1970's, to the high in 1981. On June 23, 1981, the PTI recorded a bull market high of 1510. That meant that the PTI had climbed a total of 1385 points during the period of 1974 to 1981.

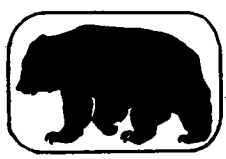
During that seven year climb there were six corrections worthy of the name, and this includes all the action up to the June 23, 1981 top. The largest and most significant of those corrections occurred during 1977-78. The PTI hit a high of 904 on July 22, 1977, then turned down. By March 1, 1978, the PTI recorded its correction low of 688. The drop erased 216 points from the PTI over a period of 32 weeks. As a measure of comparable market action, the advance-decline ratio during that same period lost a total of 5.15 points. That was the severest correction during the seven year period.

Now let's compare the 1977-78 correction with the bear market that began on June 23, 1981. So far the PTI has lost a total of 168 points against the total of 216 points during 1977-78. But as of this writing, the 1981-82 correction has lasted 37 weeks compared with 32 weeks in 1977-1978. Yet the most striking comparison in the two periods is in breadth (A-D ratio). Whereas the 1977-78 correction lopped off a total of 5.15 points from the A-D ratio, the drop from the 1981 high has already sliced 9.89 points from the A-D ratio. Thus, the A-D has lost almost twice as much in 1981-82 as it did during 1977-78. And this in the face of a smaller drop (so far) in the PTI.

But the main reason I am presenting the long-term study of the PTI at this particular time is as follows: the PTI is now in danger of violating the major trendline which extends from the 1974 bottom. A secondary trendline has been drawn connecting the 1978 and 1980 lows. That secondary trendline was broken during late-1980. But a much more important move will occur if the eight-year trendline from the 1974 low is broken.

As this is written, the PTI is within 12 points of the 1974-1980 trendline. Any deterioration from here will surely take the PTI below that trendline. If that happens, the implications are that the PTI is in a primary bear market that will (in due time) correct the entire 1385 point rise which started from the 1974 bottom.

INVESTMENT POSITION: In the last Letter I suggested a position of up to 15% in long-term T-bonds. Put another 10% in 3-5 year T-notes now (although I consider both of these positions optional, not mandatory). Also, don't be worried about getting the peak interest rates on every T-bill rollover. AVERAGE T-bill yields over the next 12 months should be high. Moreover, the money markets are fantastically VOLATILE now, and it's fruitless trying to beat a volatile and bouncing market.



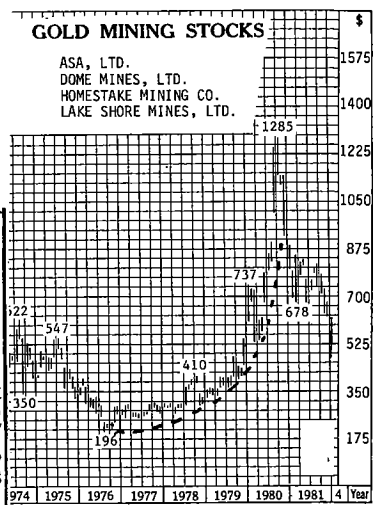
Meanwhile, the bear continues in control of this box. Fight him at your own risk.

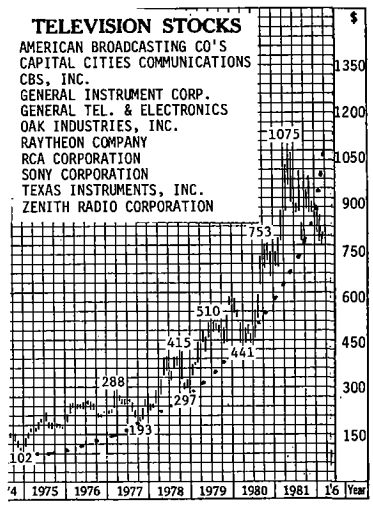
PARABOLA: One of the most important but least understood chart formations is the exponential rise—sometimes referred to as the parabolic curve. From my readings of hundreds of services over the years, I would say that only Joe Granville ever makes intelligent mention of the parabola.

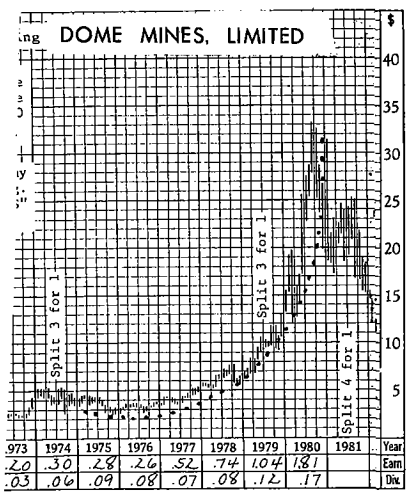
The parabolic curve (rise) is a movement that starts up slowly, often out of a dip, then gathers velocity and increases its angle of ascent as it matures. The parabola rockets to an almost vertical climb as it speeds to its ultimate conclusion. The accelerating rising trend of the parabola can be traced with an instrument known to draftsmen and chartists as the French curve.

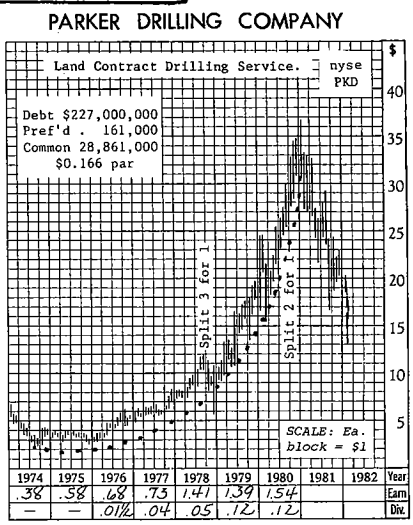
The importance of the parabola is that it indicates rising optimism, then an intense buying interest, and finally a frenzy—or buying panic. When the parabola reaches the near-vertical, it is fairly certain that "the very best of the best is being discounted." Once the parabolic curve is broken (usually with a frightening plunge), it is a safe assumption that the price movement will continue down for many months or even years—often back to the base from which the entire rise began.

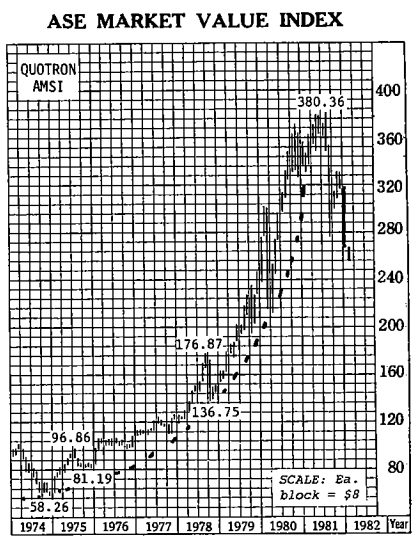
As a rule, the parabolic rise can be seen most clearly on a monthly, arithmetic chart. For this purpose I prefer the charts of Horsey, Salisbury, MD 21801. (which I am using in this piece).











The most famous recent parabola was seen in gold and in the gold mining stocks. I include the Gold Mining Stock Average (it's Barron's Average), and here we see the rise starting in 1976, the accelerated parabolic advance through the late-1970's, and finally the spear-point top of 1980. Next, the crash into early-1981, the 1981 rally (which formed the right shoulder of a head-and-shoulders top) then the most recent break, a break which completed the distribution pattern.

The same pattern appears in Dome Mines. DM, by the way, has long been considered the perfect inflation hedge since it holds gold mines and a huge interest in highly-leveraged Dome Petroleum . The fact that Dome is coming down from a parabolic blow-off top does not enhance the argument of those who believe that more inflation is still in the cards.

Another important current parabolic chart is that of the AMEX Value Index. This Index recently "blew its top" following a parabolic rise, and has now smashed down the 270 level. Those hoping or predicting a near-by return to speculation and froth on Wall Street (and the AMEX is the speculative exchange) might revise their thinking upon study of this chart.

I include here a chart of the spectacular parabolic curve and smash in Parker Drilling, and this is just one of maybe 25 parabolas now visible on the charts (significantly almost all the parabolas have now broken).

One particularly fascinating item is the parabola in the Television group. It is too early to tell whether this parabola is completed yet—or whether there is a final blow-off coming in this group. At any rate, I would say that the TV connected stocks are now in the danger zone, and some (such as Viacom) have already run into trouble.

Obvious parabola stocks which are in the bear market stage are Fairchild Industries, Sanders Assoc., Ogden Corp., Advanced Micro-Devices, many oil stocks, most S. African golds, Florida Steel, Gearhart Indust., Handy & Harman, Metromedia (now blowing off).

NOTES & QUOTES: Shades of depression: Dun & Bradstreet reported that for the week ending February 11 business failures rose to the highest level (529) since 1939 or when the record was first started.

* *

The cost of military weapons and systems continues to soar out of sight for the US. The Pentagon reported that since last March the cost of building 18 Army, Navy and Air Force weapons has increased by at least 15% to 25%. Weapons up at least 25% are Roland Air Defense missile (Army), Hellfire lasar Air-to-ground missile, Pershing 11 nuclear missile, AH-64 Apache Attack heliocopter, SSN-688 class nuclear attack submarine, F-14A Tomcat fighter, and on and on.

* *

How did "merger mania" work out? In many cases not too well. It's been my contention all along that corporations should have been building up cash in order to weather the liquidity squeeze—rather than borrowing or spending billions to buy other corporations or to buy back their own stocks. Anyway, here are some of the results:

RCA is trying to dump its Hertz subsidiary. RCA's $1.1 billion purchase of C.I.T. has not proved a bonanza either.....ITT is also trying to get rid of many of its recent acquistions.....Mobil Oil came a cropper with its ill-advised purchase of the money losing Montgomery Ward.....Philip Morris is losing money with its 7-Up acquisition .....General Foods (having paid a fat $470 million for Oscar Mayer) is wondering why it bought that outfit.....After Fluor bought St. Joe Mineral its shares dropped 50%.....DuPont bought Conoco just before the collapse in the energy stocks, and now DuPont's stock is down and its debt rating has been lowered.....US Steel's takeover of Marathon Oil has hardly helped the stock (as you will note if you look at a chart of Big Steel).

* *

Help! I'm being flooded with letters from subscribers. Many of you have sent me your portfolios, and you want to know what I think. Others don't understand the A-D ratio or the PTI or why I draw trendlines the way I do or how to buy T-bills. I'd love to answer each and every question. But I can't. If I tried I'd be turning myself into a sort of "financial Dear Abby." Which is OK, but I also wouldn't get any work done, and on top of that I'd be exhausted. So I do the best I can, but if you've written to me wanting to know how they compute the Dow or whether I think you should sell your General Motors don't be upset if you don't get an answer. I've got to survive or nobody will get anything from Richard Russell.

* *

Paula just bought a video tape for our video-recorder. I'ts called "Aerobicise," and it's quite a tape. The tape features aerobic exercise by six of the best-built and most energetic girls these tired eyes have ever seen. Aerobics is now sweeping the country (see this month's Life Magazine), and this tape is a gem if you want to try to follow the exercises. I can last about 10 minutes (before I'm exhausted) but I think it's great fun. And if you drop to the floor in a pool of perspiration (as I do), you can rest up while watching those six maidens do their stuff. Heartily recommended for men (and women) of all ages. But check with the doctor first.

* *

My subscribers tend to move a lot and travel a lot. A real aid in finding a new place to live is the "Places Rated Almanac" by Boyer and Savageau (Rand McNally). The book rates 277 cities for nine categories (climate, housing, crime, health care, arts, recreation, economics, etc) and comes up with cumulative scores for each city. The classifications are very interesting, although I don't agree on many of the conclusions. Here are their first 10 all around preferred cities 1-Atlanta, 2-Washington DC, 3-Greensboro, Winston-Salem, NC, 4-Pittsburgh, 5-Seattle, 6-Philadelphia, 7-Syracuse, 8-Portland, 9-Raleigh-Durham, 10-Dallas (what no California cities in the first 10!).

* *

Well, I finally did it. After all these years I finally, along with my wife Paula, got on the plane and took the big one hour trip to Las Vegas. We stayed at Caesar's Palace. This is a huge hotel, and like all the other hotels on "The Strip" you have to wade through the gambling casino to get to the elevators. What did I think of Vegas? I'm not a gambler, and I've never enjoyed pitting my money against losing odds, so I guess I, personally, would describe the whole Vegas scene as pathetic, tacky and a

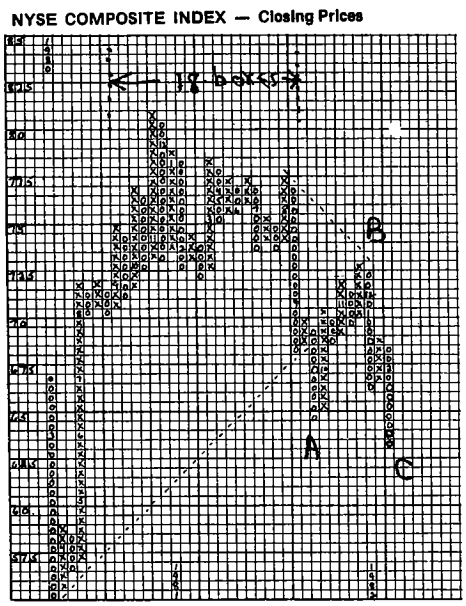
bit sick. Pathetic because few people can afford to lose their money. Tacky, because the sight of thousands of people (nobody smiles) sitting around tables or pulling slot-machine handles is just that–a tacky sight. And a bit sick because all this time is spent trying to win money, when it's documented that over the long run the house wins the money and you gain the experience.

We saw the "fabulous" Jubilee show at the MGM. The sets were indeed amazing, the customes were fantastic, the show was a series of dancing (much of it topless) numbers built around familiar themes (Sampson and Delilah, sinking of the Titanic, etc.). The show was worth seeing because of the spectacular sets, but that's about it.

The city of Vegas is no center of beauty, and I thought that with proper planning it could have been at least as attractive as say Palm Springs or Phoenix. But there is a lot of sprawl and very little in the way of grass, plantings, palm trees.

We drove to nearby Boulder City and saw the massive Hoover Dam, and I kind of liked Boulder City. If you're looking for a hide-away in a no-income tax state, here is a little known spot worth investigating.

STOCK NOTE: This is the very bearish point & figure chart that I alluded to in the last Letter (page 6). The chart is courtesy of Chartcraft, Larchmont, NY. On a horizontal count (18 boxes across) I get a projection from the peak of 54 boxes down (since this is a 3-box reversal the 18 must be multiplied by 3 which is 54). That gives a minimum projection down of 56 on the NYSE Index. On a vertical count down, I get a final minimum count of 51.5.



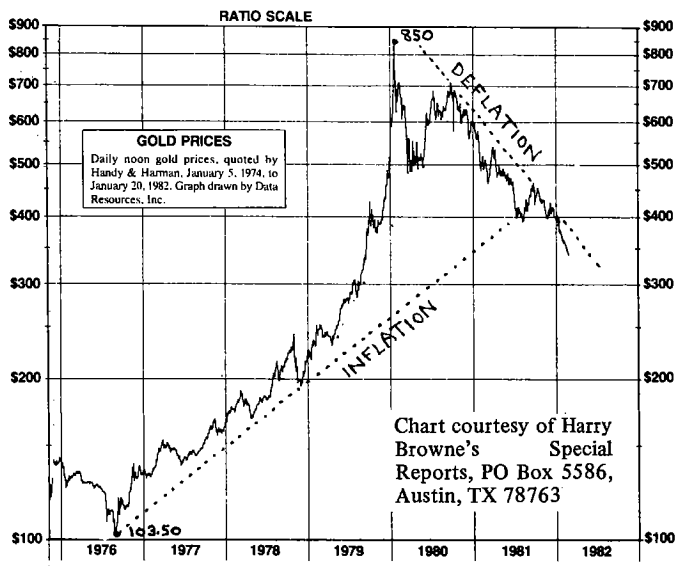
We have a massive top on this chart, a break down to point A at the 65 level. Then the Index rallied to resistance at B in the 73 area, and a new distribution pattern was formed. A new break occurred at point C, and thus we have two major distributions and no particular support on the chart until the 55-60 area.

GOLD: Those who think declining gold prices constitute a boon for the nation are going to be very disappointed. Gold has now lost 62% of its entire rise from $35 an ounce to $850 an ounce. This is a harbinger of deflation. It's an early signal pointing to the coming "panic for cash" (an event that I warned about all during 1980 and '81).

Remember back a few years ago when people were blithely telling you to "get rid of your worthless dollars and borrow, owe, and load up with collectibles, antique cars, gold, silver, art and coins." The situation is now reversed. Those lowly dollars are now the hottest thing around, and corporations are paying out fewer of them to their employees, people are spending fewer of them for diamonds, gold, stocks, homes what have you. Nobody's put it all together–yet, but remember, a bear market in gold is a harbinger of things to come, just as surely as a bear market in stocks is. By summer a generation which hardly knows the meaning of the word–will be openly talking about deflation.

This ratio chart shows the action in gold since 1976. I have labeled the action up to early-1980 as inflationary. When gold broke below its 1976-81 trendline I marked the action deflationary. I think that's just what the gold market is telling us. We should know by early summer.

Meanwhile, the moving averages for gold are as follows: the 50-week (primary trend) MA is 430, the 13-week is 381 and the 5-week is 364. Gold is an extraordinary 20 points below its shortest term or 5-week MA. We wait.



LATE NOTES: With the Averages all under their September lows, the week of March 5 ended with whopping losses of $40 billion (as measured by the Wilshire 5000 Index). Volume on the NYSE was an all-time record of 328 million shares for the week. I'd call that liquidation, wouldn't you? My market diary made for sour reading . . . .cumulative most-active stock index at a new 1982 low of 1201 on Mar. 4; Dow A-D a new low of 40 on Mar. 4; D-J Industrials at new 1982 low of 807.36 on Mar. 4; D-J Transports, D-J 65 Stock Average, S&P 500, Wilshire, NYSE Index, PTI, NYSE A-D ratio, positive and negative volume ALL at new lows on Mar. 5. The water in the market bathtub continues to run out. What more can I say!

NEXT MAILING: March 24, 1982